

**Artesian Water Company, Inc.
(A Wholly Owned Subsidiary of
Artesian Resources Corporation)**

Financial Statements

Years Ended December 31, 2010 and 2009

The report accompanying these financial statements was issued by
BDO USA, LLP, a Delaware limited liability partnership and the U.S. member of
BDO International Limited, a UK company limited by guarantee.

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(A Wholly Owned Subsidiary of
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Independent Auditors' Report

To the Board of Directors and Stockholders
Artesian Water Company, Inc.
Newark, Delaware

We have audited the accompanying balance sheets of Artesian Water Company, Inc. ("the Company") as of December 31, 2010 and 2009 and the related statements of operations and retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Artesian Water Company, Inc. at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Bethesda, Maryland
April 21, 2011

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Artesian Water Company, Inc.

Balance Sheets (In Thousands)

December 31,	2010	2009
ASSETS		
Utility Plant, at original cost (less accumulated depreciation 2010-\$67,657; 2009-\$63,552)	\$ 305,208	\$ 299,762
Current Assets		
Cash and cash equivalents	4	195
Accounts receivable (less allowance for doubtful accounts 2010-\$124; 2009-\$97)	3,109	3,156
Receivables-related party	258	5,821
Unbilled operating revenues	3,614	3,518
Materials and supplies - at cost on first-in first-out basis	1,243	1,218
Prepaid property taxes	1,257	1,220
Prepaid expenses and other	1,596	941
	11,081	16,069
Other Assets		
Non-utility property (less accumulated depreciation 2010-\$65; 2009-\$55)	193	191
Other deferred assets	4,405	4,255
	4,598	4,446
Regulatory Assets	1,242	1,613
	\$ 322,129	\$ 321,890
Liabilities and Capital		
Capitalization		
Common stock-\$1 par value (1,000 shares authorized, issued and outstanding)	\$ 1	\$ 1
Additional paid-in-capital	63,616	63,616
Retained earnings	20,912	19,177
Total stockholder's equity	84,529	82,794
Long-term debt, net of current portion	104,481	104,864
	189,010	187,658
Commitments and Contingencies		
Current Liabilities		
Lines of Credit	5,588	12,929
Current portion of long-term debt	964	950
Accounts payable	3,297	3,243
Accrued expenses	1,978	595
Overdraft payable	650	1,016
Loan payable to parent	1,655	---
Deferred income taxes	531	491
Accrued interest	1,148	1,328
Customer deposits	805	592
Other	1,599	1,389
	18,215	22,533
Deferred Credits and Other Liabilities		
Net advances for construction	15,978	18,221
Postretirement benefit obligation	524	737
Deferred investment tax credits	664	685
Deferred income taxes	36,981	33,615
	54,147	53,258
Net Contributions In Aid of Construction	60,757	58,441
	\$ 322,129	\$ 321,890

See accompanying summary of significant accounting policies and notes to financial statements.

Artesian Water Company, Inc.

Statements of Operations and Retained Earnings (In Thousands)

<i>Year Ended December 31,</i>	2010	2009
Operating Revenues		
Water sales	\$ 56,608	\$ 53,806
Other	1,439	1,227
	58,047	55,033
Operating Expenses		
Operation and maintenance expenses	29,469	27,792
Depreciation and amortization	6,567	6,176
Taxes		
State and federal income deferred	4,861	4,635
Property and other	3,478	3,257
	44,375	41,860
Operating Income	13,672	13,173
Other Income, Net		
Allowance for funds used during construction (AFUDC)	136	382
Miscellaneous	465	407
Income Before Interest Charges	14,273	13,962
Interest Charges		
Long-term debt	6,743	6,796
Short-term debt	121	68
Amortization of debt expense	117	116
Other	48	34
	7,029	7,014
Net Income	7,244	6,948
Retained Earnings, beginning of year	19,177	18,106
Less: dividends to parent company	5,509	5,877
Retained Earnings, end of year	\$ 20,912	\$ 19,177

See accompanying summary of significant accounting policies and notes to financial statements.

Artesian Water Company, Inc.

Statements of Cash Flows (In Thousands)

Year Ended December 31,	2010	2009
Cash Flows From Operating Activities		
Net income	\$ 7,244	\$ 6,948
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,567	6,176
Deferred income taxes, net	3,385	4,447
AFUDC	(136)	(382)
Changes in assets and liabilities:		
Accounts Receivable, net of allowance for doubtful accounts	5,610	(168)
Unbilled operating revenues	(96)	79
Materials and supplies	(25)	(74)
Regulatory assets	371	238
Postretirement benefit obligation	(213)	(75)
Other deferred assets	(187)	(148)
Prepaid property taxes	(37)	(103)
Prepaid expenses and other	(655)	(463)
Accounts payable	54	(1,371)
Accrued expenses	1,383	(1,807)
Accrued interest	(180)	152
Customer deposits and other, net	423	(340)
Net cash provided by operating activities	23,508	13,109
Cash Flows From Investing Activities		
Capital expenditures (net of AFUDC)	(13,080)	(13,171)
Proceeds from sales of assets	61	41
Net cash used in investing activities	(13,019)	(13,130)
Cash Flows From Financing Activities		
Net (repayments) borrowings under lines of credit agreements	(7,341)	5,106
Deferred debt issuance costs	36	115
Loan from parent company	1,655	-
Net proceeds from issuance of common stock	-	950
Principal repayments of long-term debt	(369)	(936)
(Decrease) increase in overdraft payable	(366)	277
Net advances and contributions in aid of construction	1,214	214
Dividends to parent company	(5,509)	(5,877)
Net cash used in financing activities	(10,680)	(151)
Net decrease in cash and cash equivalents	(191)	(172)
Cash and cash equivalents, Beginning of year	195	367
Cash and cash equivalents, End of year	\$ 4	\$ 195
Supplemental Disclosures of Cash Flow Information:		
Utility plant received as construction advances and contributions	\$ 47	\$ 324
Supplemental Disclosures of Cash Flow Information:		
Interest paid	\$ 7,209	\$ 6,862

See accompanying summary of significant accounting policies and notes to financial statements.

Artesian Water Company, Inc.

Summary of Significant Accounting Policies

Basis of Accounting

Artesian Water Company, Inc., Artesian Water or the Company, is a wholly-owned subsidiary of Artesian Resources Corporation, or Artesian Resources. The Company provides water utility service to customers within its established service areas in Delaware, pursuant to rates filed with and approved by the Delaware Public Service Commission (the "DEPSC"). As of December 31, 2010, the Company served approximately 77,900 customers. The accounting records of the Company are maintained in accordance with the uniform system of accounts as prescribed by the DEPSC. The Company follows the provisions of the Financial Accounting Standards Board Accounting Standards Codification, or FASB ASC, Topic 980, which provides guidance for companies in regulated industries.

Utility Plant

All additions to plant are recorded at cost. Cost includes direct labor, materials, and indirect charges for such items as transportation, supervision, pension, and other fringe benefits related to employees engaged in construction activities. When depreciable units of utility plant are retired, the cost of retired property, together with any cost associated with retirement and less any salvage value or proceeds received, is charged to accumulated depreciation. Maintenance, repairs, and replacement of minor items of plant are charged to expense as incurred.

In accordance with a rate order issued by the DEPSC, Artesian Water accrues an Allowance for Funds Used During Construction or AFUDC. AFUDC, which represents the cost of funds devoted to construction projects through the date the project is placed in service, is capitalized as part of construction work in progress. The rate used for the AFUDC calculation is based on Artesian Water's weighted average cost of debt and the rate of return on equity authorized by the DEPSC. The rate used to capitalize AFUDC in 2010 and 2009 was 7.9% and 7.7%, respectively.

Artesian Water Company, Inc.

Summary of Significant Accounting Policies

Utility plant at December 31, comprised of:

<i>In thousands</i>	<i>Estimated Useful Life In Years</i>	<i>December 31, 2010</i>	<i>2009</i>
Utility plant at original cost			
Utility plant in service			
Intangible plant	-	\$ 140	\$ 140
Source of supply plant	45-85	15,938	15,855
Pumping and water treatment plant	35-62	54,731	54,229
Transmission and distribution plant			
Mains	81	176,927	170,854
Services	39	29,702	28,522
Storage tanks	76	20,938	20,912
Meters	26	17,133	14,765
Hydrants	60	9,630	9,275
General plant	3-31	42,389	43,493
Property held for future use	-	1,876	1,260
Construction work in progress	-	3,461	4,009
		372,865	363,314
Less - accumulated depreciation		67,657	63,552
		\$ 305,208	\$ 299,762

Depreciation and Amortization

For financial reporting purposes, depreciation is recorded using the straight-line method at rates based on estimated economic useful lives, which range from 3 to 85 years. Composite depreciation rates for water utility plant were 2.18% for 2010 and 2.25% for 2009. In a rate order issued by the DEPSC, the Company was directed effective January 1, 1998 to begin using revised depreciation rates for utility plant. In rate orders issued by the DEPSC, Artesian Water was directed effective May 28, 1991 and August 25, 1992 to offset depreciation on utility property funded by Contributions in Aid of Construction, CIAC, and Advances for Construction, Advances, respectively, against CIAC and Advances. Other deferred assets are amortized using the straight-line method over applicable lives, which range from 2 to 40 years.

Regulatory Assets

FASB ASC Topic 980 stipulates generally accepted accounting principles for companies whose rates are established by or are subject to approval by a third-party regulatory agency. Certain expenses are recoverable through rates charged to our customers, without a return on investment, and are deferred and amortized during future periods using various methods as permitted by the DEPSC. Depreciation and salary study expenses are amortized on a straight-line basis over a period of five years, while all other expenses related to rate proceedings and applications to increase rates are amortized on a straight-line basis over a period of two years. The postretirement benefit obligation, which is being amortized over twenty years, is adjusted for the difference between the net periodic postretirement benefit costs and the cash payments. The amount recognized in the financial statements is determined on an actuarial basis, which uses assumptions about inflation,

Artesian Water Company, Inc.

Summary of Significant Accounting Policies

mortality, medical trend rates and discount rates. The deferred income taxes will be amortized over future years as the tax effects of temporary differences previously flowed through to the customers reverse.

Regulatory assets at December 31, net of amortization, comprise:

<i>In thousands</i>	2010	2009
Postretirement benefit obligation	\$ 637	\$ 849
Deferred income taxes recoverable in future rates	521	536
Expense of rate proceedings	84	228
	<u>\$ 1,242</u>	<u>\$ 1,613</u>

Impairment or Disposal of Long-Lived Assets

Our long-lived assets consist primarily of utility plant in service and regulatory assets. A review of our long-lived assets is performed in accordance with the requirements of FASB ASC Topic 360. In addition, the regulatory assets are reviewed for the continued application of FASB ASC Topic 360. The review determines whether there have been changes in circumstances or events that have occurred requiring adjustments to the carrying value of these assets. FASB ASC Topic 360 stipulates that adjustments to the carrying value of these assets would be made in instances where the inclusion in the rate-making process is unlikely.

Other Deferred Assets

Debt issuance costs are amortized over the term of the related debt, which range from 10 to 30 years. The investment in Co-Bank, which is a cooperative bank, is related to certain outstanding First Mortgage Bonds and is a required investment in the bank based on the underlying long term debt agreements.

Other deferred assets at December 31, net of amortization, comprised:

<i>In thousands</i>	2010	2009
Debt issuance expense	\$ 2,300	\$ 2,356
Investment in Co-Bank	2,067	1,840
Other	38	59
	<u>\$ 4,405</u>	<u>\$ 4,255</u>

Advances for Construction

Water mains, services and hydrants, or cash advances to reimburse Artesian Water for its costs to construct water mains, services and hydrants are contributed to Artesian Water by customers, real estate developers and builders in order to extend water service to their properties. The value of these contributions is recorded as Advances for Construction. Artesian Water makes refunds on

Artesian Water Company, Inc.

Summary of Significant Accounting Policies

these advances over a specific period of time based on operating revenues generated by the specific plant or as new customers are connected to the mains. After all refunds are made within the contract period, any remaining balance is transferred to CIAC.

Contributions in Aid of Construction

CIAC includes the non-refundable portion of advances for construction and direct contributions of water mains, services and hydrants, or cash to reimburse for costs to construct water mains, services and hydrants.

Income Taxes

The Company is included in the consolidated tax returns of its parent, Artesian Resources Corporation. However, for financial statement purposes, the Company calculates its tax provision on a separate return basis.

Deferred income taxes are provided in accordance with FASB ASC Topic 740 on all differences between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements based on the enacted tax rates expected to be in effect when such temporary differences are expected to reverse. Under FASB ASC Topic 740, the Company analyzed its various tax positions and determined that no further entry, recognition or derecognition was required. The Company would recognize, if applicable, interest accrued and penalties related to unrecognized tax benefits in interest expense and in accordance with the regulations of the jurisdictions involved.

The Tax Reform Act of 1986 mandated that Advances and CIAC received subsequent to December 31, 1986, generally are taxable income. The 1996 Tax Act provided an exclusion from taxable income for CIAC and Advances received after June 12, 1996 by our utilities except for certain contributions for large services that are not included in rate base for rate-making purposes.

Investment tax credits were deferred through 1986 and are recognized as a reduction of deferred income tax expense over the estimated economic useful lives of the related assets.

Revenue Recognition and Unbilled Revenues

Water service revenue for financial statement purposes includes amounts billed to customers on a quarterly or monthly cycle basis, depending on class of customer, and unbilled amounts based upon estimated usage from the date of the last meter reading to the end of the accounting period. As actual usage amounts are received, adjustments are made to the unbilled estimates in the next billing cycle based on the actual results.

Artesian Water Company, Inc.

Summary of Significant Accounting Policies

Accounts Receivables

Accounts receivable are recorded at the invoiced amounts. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in our existing accounts receivable. The Company reviews the allowance for doubtful accounts on a quarterly basis. Account balances are written off against the allowance when it is probable the receivable will not be recovered. The allowance for doubtful accounts was \$124,000 at December 31, 2010 and \$97,000 at December 31, 2009. The corresponding expense for the year ended December 31, 2010 and 2009 was \$292,000 and \$231,000, respectively. The following table summarizes the changes in the Company's accounts receivable balance:

Receivables at December 31, comprised:

<i>In thousands</i>	2010	2009
Customer accounts receivable - water	\$ 3,143	\$ 3,017
Receivables-Intercompany	258	5,821
Other	90	236
	3,491	9,074
Less allowance for doubtful accounts	124	97
Net accounts receivable	\$ 3,367	\$ 8,977

The activities in the allowance for doubtful accounts are as follows:

Allowances at December 31, comprised:

<i>In thousands</i>	2010	2009
Beginning balance	\$ 97	\$ 75
Allowance adjustments	292	231
Recoveries	68	73
Write off of uncollectible accounts	(333)	(282)
Ending balance	\$ 124	\$ 97

Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the Company considers all temporary cash investments with an original maturity of three months or less to be cash equivalents. The Company utilizes its bank's zero balance account disbursement service to reduce the use of their lines of credit by funding checks as they are presented to the bank for payment rather than at issuance. If the checks currently outstanding, but not yet funded, exceed the cash balance on our books, the net liability is recorded as a current liability on the balance sheet in the Overdraft Payable account.

Artesian Water Company, Inc.

Summary of Significant Accounting Policies

Use of Estimates in the Preparation of the Financial Statements

The financial statements were prepared in conformity with generally accepted accounting principles in the U.S., which require management to make estimates about the reported amounts of assets and liabilities including unbilled revenues, reserve for a portion of revenues received under temporary rates and regulatory asset recovery and contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's estimate.

Artesian Water Company, Inc.

Notes to Financial Statements

1. Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value.

Current Assets and Liabilities

For those current assets and liabilities that are considered financial instruments, the carrying amounts approximate fair value because of the short maturity of those instruments.

Long-term Financial Liabilities

The fair value of the Company's long-term debt as of December 31, 2010 and December 31, 2009, determined by discounting their future cash flows using current market interest rates on similar instruments with comparable maturities as guided under FASB ASC 825 are shown as below:

<i>In thousands</i>	December 31,	
	2010	2009
Carrying amount	\$ 104,481	\$ 104,864
Estimated fair value	111,091	102,450

The fair value of Advances for Construction cannot be reasonably estimated due to the inability to accurately estimate the timing and amounts of future refunds expected to be paid over the life of the contracts. Refund payments are based on the water sales to new customers in the particular development constructed. The fair value of Advances for Construction would be less than the carrying amount because these financial instruments are non-interest bearing.

2. Income Taxes

The difference between the effective tax rate (2010 - 40.2%; 2009 - 40.0%) and the amount derived by multiplying income before federal and state income taxes by the effective statutory federal income tax rate of 34% in 2010 and 2009 is primarily attributable to state income taxes.

As of December 31, 2010, the Company has federal net operating loss carry forwards aggregating approximately \$3,852,000 which will expire if unused by 2029. As of December 31, 2010, the Company has state net operating loss carry forwards ("NOL's") aggregating approximately \$9,128,000. These NOL's will expire if unused between 2023 and 2028. At December 31, 2010, for federal income tax purposes, there were alternative minimum tax credit carry-forwards aggregating approximately \$3,775,000 resulting from the payment of alternative minimum tax in current and prior years. These alternative minimum tax credit carry-forwards may be carried forward indefinitely to offset future regular federal income taxes. The Company has not recorded a valuation allowance for these tax carry forwards, because the Company believes it is more likely than not that such benefits will be realized.

Artesian Water Company, Inc.

Notes to Financial Statements

Under FASB ASC Topic 740, an uncertain tax position represents our expected treatment of a tax position taken, or planned to be taken in the future, that has not been reflected in measuring income tax expense for financial reporting purposes. As a result of our review of Artesian's tax positions, we determined that we had no material uncertain tax positions. The Company would recognize, if applicable, interest accrued and penalties related to unrecognized tax benefits in interest expense and in accordance with the regulations of the jurisdictions involved. There were no such interest and penalty charges for the period ended December 31, 2010 or December 31, 2009. The Company remains subject to examination by state authorities for the tax years 2007 through 2010 and by federal authorities for tax years 2009 through 2010.

Deferred income taxes are comprised of the following:

<i>In thousands</i>	December 31, 2010	2009
Alternative minimum tax credit carry forwards	\$ 3,775	\$ 2,547
Bad debt allowance	90	80
Federal and state NOL's	1,834	4,345
Other	-	17
Total deferred tax assets	5,699	6,989
Deferred tax liabilities related to:		
Property, plant and equipment basis differences	(42,343)	(40,277)
Expenses of rate proceedings	(18)	(91)
Property taxes	(500)	(485)
Regulatory asset	(207)	(212)
Other	(143)	(30)
Total deferred tax liabilities	(43,211)	(41,095)
Net deferred tax liability	\$ (37,512)	\$ (34,106)

Deferred taxes, which are classified into a net current and non-current balance, are presented in the balance sheet as follows:

<i>In thousands</i>	December 31, 2010	2009
Current deferred tax liability	\$ (531)	\$ (491)
Non-current deferred tax liabilities	(36,981)	(33,615)
Net deferred tax liability	\$ (37,512)	\$ (34,106)

3. Lines of Credit

Artesian Water has a \$20 million line of credit with Co-Bank, ACB that allows for the financing of operations for Artesian Water, with up to \$10 million of this line available for the operations of Artesian Water Maryland, Inc. The interest rate for borrowings under this line is the London

Artesian Water Company, Inc.

Notes to Financial Statements

Interbank Offered Rate, or LIBOR, plus 1.50%. The term of this line of credit expires on January 17, 2012. Artesian Resources has a \$40 million line of credit with Citizens Bank, or Citizens, which is available to all subsidiaries of Artesian Resources. The interest rate for borrowings under this line is based on LIBOR. This is a demand line of credit and therefore the financial institution may demand payment for any outstanding amounts at any time. The term of this line of credit expires on the earlier of January 18, 2012 or any date on which Citizens demands payment.

At December 31, 2010, Artesian Water had \$5.6 million outstanding under these lines at an average interest rate of 1.7%. The maximum amount outstanding was \$9.0 million. The twelve-month average amount outstanding was approximately \$6.0 million at a weighted average annual interest rate of 1.6%.

At December 31, 2009, Artesian Water had available two unsecured lines of credit totaling \$40 million, which were shared with Artesian Water Maryland, Inc. Borrowings under these lines of credit were based on the LIBOR, plus 1.0% for 30, 60, 90, or 180 days or the banks' federal funds rate plus 1.0%, at the option of the Company. The balances on these two lines were transferred to new lines of credit in January 2010 and these lines of credit held by Artesian Water were terminated.

At December 31, 2009, Artesian Water had \$12.9 million outstanding under these lines at an average interest rate of 1.0%. Approximately \$5.5 million of the amount outstanding at December 31, 2009 was borrowed for use by Artesian Water Maryland, Inc. The maximum amount outstanding was \$13.8 million in 2009. The twelve-month average amount outstanding was approximately \$11.2 million at a weighted average annual interest rate of 1.1% in 2009.

4. Long-Term Debt

As of December 31, 2010 and 2009, substantially all of Artesian Water's utility plant was pledged as security for the First Mortgage Bonds. In addition, the trust indentures relating to these First Mortgage Bonds contain covenants which limit long-term debt, including the current portion thereof, to 66 2/3% of total capitalization including the current portion of the long-term debt, and which, in certain circumstances, could restrict the payment of cash dividends. As of December 31, 2010, however, no dividend restrictions were imposed under these covenants.

Artesian Water Company, Inc.

Notes to Financial Statements

<i>In thousands</i>	December 31, 2010	2009
First mortgage bonds		
Series O, 8.17%, due December 29, 2020	\$ 20,000	\$ 20,000
Series P, 6.58%, due January 31, 2018	25,000	25,000
Series Q, 4.75%, due December 1, 2043	15,400	15,400
Series R, 5.96%, due December 31, 2028	25,000	25,000
Series S, 6.73%, due December 31, 2033	13,800	14,400
	99,200	99,800
State revolving fund loans		
4.48%, due August 1, 2021	2,827	3,022
3.57%, due September 1, 2023.	1,076	1,140
3.64%, due May 1, 2025	1,761	1,852
3.41%, due February 1, 2031	581	-
	6,245	6,014
Sub-total	105,445	105,814
Less: current maturities	964	950
Total long-term debt	\$ 104,481	\$ 104,864

Payments of principal amounts due during the next five years and thereafter:

<i>In thousands</i>	2011	2012	2013	2014	2015	Thereafter
First Mortgage bonds	\$ 600	\$ 600	\$ 600	\$ 600	\$ 600	\$ 96,200
State revolving fund loans	364	411	417	434	452	4,167
Total payments	\$ 964	\$ 1,011	\$ 1,017	\$ 1,034	\$ 1,052	\$ 100,367

5. Employee Benefit Plans

401(k) Plan

Artesian Resources has a defined contribution 401(k) Salary Deduction Plan, or the "401(k) Plan," which covers substantially all employees of Artesian Water. Under the terms of the 401(k) Plan, the Company contributed 2% of eligible salaries and wages and matches employee contributions up to 6% of gross pay at a rate of 50%. The Company may, at its option, make additional contributions of up to 3% of eligible salaries and wages. No such additional contributions were made in 2010 and 2009. The 401(k) Plan expenses, which include Company contributions and administrative fees, for the years 2010 and 2009, were approximately \$624,000 and \$563,000, respectively.

Artesian Water Company, Inc.

Notes to Financial Statements

Supplemental Pension Plan

Effective October 1, 1994, Artesian Water established a Supplemental Pension Plan, or the "Supplemental Plan," to provide additional retirement benefits to full-time employees hired prior to April 26, 1994. The Supplemental Plan is a defined contribution plan that enables employees to save for future retiree medical costs, which will be paid by employees. The Supplemental Plan accomplishes this objective by providing additional cash resources to employees upon a termination of employment or retirement, to meet the cost of future medical expenses. Artesian Water has established a contribution based upon each employee's years of service ranging from 2% to 6% of eligible salaries and wages. Artesian Water also provides additional benefits to individuals who were over age 50 as of January 1, 1994. These individuals are referred to as the "Transition Group." Effective November 1, 1994, individuals eligible for the Transition Group had the opportunity to defer compensation to the Supplemental Plan, and to receive a transition matching contribution for 5 years. Each one-dollar of eligible salaries and wages deferred by the Transition Group was matched with three, four, or five dollars by Artesian Water based on the employee's years of service subject to certain limitations under the federal tax rules. Plan expenses, which include Company contributions and administrative fees, for the years 2010 and 2009, were approximately \$263,000 and \$268,000, respectively.

Postretirement Benefit Plan

The Company has a Postretirement Benefit Plan, or the "Benefit Plan," which provides medical and life insurance benefits to certain retired employees. Prior to the amendment of the Benefit Plan, substantially all employees could become eligible for these benefits if they reached retirement age while still working for Artesian Water.

FASB ASC Topic 715 stipulates that Artesian Water accrue the expected cost of providing postretirement health care and life insurance benefits as employees render the services necessary to earn the benefits. Artesian Resources elected to defer recognition and amortize its transition obligation over twenty years beginning in 1993.

The Company recognized an offsetting regulatory asset with respect to its post retirement liability. This asset is recorded based on the DEPSC order, which permits Artesian Water to continue recovery of postretirement health care and life insurance expense on a pay-as-you-go basis for the remaining eligible employees. Artesian Water expects its post retirement obligation and related expense recovery to cover a period of approximately 20 years (based on the age and life expectancy of the remaining eligible participants). Further, expenses recovery as a percentage of rates is expected to remain generally constant over the initial years, and then decline until the obligation is liquidated. The amounts recognized in financial statements are determined based on an actuarial basis, which uses assumptions about inflation, mortality, medical trend rates and discount rates. A change in these assumptions could cause actual results to differ from those reported. Amounts charged to expense were approximately \$115,000 and \$114,000 for 2010 and 2009, respectively.

Artesian Water Company, Inc.

Notes to Financial Statements

The Company uses December 31 as the measurement date to determine the postretirement benefit obligation. According to our actuarial report, the funded status of our defined benefit postretirement plan was calculated contemplating FASB ASC Topic 715 and the obligation is recorded at that amount. There was no other comprehensive income impact because we record a regulatory asset as provided by FASB ASC Topic 980. Additional disclosures required for our postretirement benefit obligation are presented below.

Benefit Obligations and Funded Status

<i>In thousands</i>	Year Ended December 31,	
	2010	2009
Change in Accumulated Postretirement Benefit Obligation		
Accumulated Postretirement Benefit Obligation at the		
Beginning of the Year	\$ 785	\$ 801
Service Cost	-	-
Interest Cost	44	45
Actuarial (Gain) or Loss	(40)	53
Benefits Paid	(115)	(118)
Plan Participant's Contributions	4	4
Accumulated Postretirement Benefit Obligation at the		
End of the Year	678	785
Change in Plan Assets		
Fair Value of Plan Assets at the Beginning of the Year	-	-
Benefits Paid	(115)	(118)
Employer Contributions	111	114
Plan Participant's Contributions	4	4
Fair Value of Assets at the End of the Year	-	-
Net Amount Recognized		
Funded Status	(678)	(785)
Unrecognized Transition Asset	26	34
Unrecognized Net Gain	15	(98)
Net Amount Recognized:	(637)	(849)
Amounts Recognized in the Statement of Financial Position		
Accrued Benefit Liability-Current	(112)	(112)
Accrued Benefit Liability-Noncurrent	(525)	(737)
Net Amount Recognized	\$ (637)	\$ (849)

<i>In thousands</i>	Year Ended December 31,	
	2010	2009
Weighted Average Assumptions at the End of the Year		
Discount Rate	5.50%	6.00%
Assumed Health Care Cost Trend Rates		
Health Care Cost Trend Rate Assumed for Next Year	7.00%	10.00%
Ultimate Rate	4.50%	5.00%
Year that the Ultimate Rate is Reached	2014	2015

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Net Periodic Benefit Cost

<i>In thousands</i>	Year Ended December 31,	
	2010	2009
Interest Cost	\$ 44	\$ 45
Amortization of Net (Gain) or Loss	(4)	(15)
Amortization of Transition Obligation/(Asset)	9	9
Total Net Periodic Benefit Cost	\$ 49	\$ 39

Weighted Average Assumptions		
Discount Rate	6.00%	6.00%
Assumed Health Care Cost Trend Rates		
Health Care Cost Trend Rate Assumed for Current Year	10.00%	11.00%
Ultimate Rate	5.00%	5.00%
Year that the Ultimate Rate is Reached	2015	2015

Impact of One Percentage Point in Assumed Health Care Cost Trend Rates		
	Increase	Decrease
Effect on Service Cost & Interest Cost	\$ 2	\$ (2)
Effect on Postretirement Benefit Obligation	\$ 26	\$ (24)

Contributions

Artesian Water expects to contribute \$104,000 to its postretirement benefit plan in 2011. The following table represents the approximate annual benefits expected to be paid for the years ended December 31:

	<i>(In thousands)</i> Other Benefits
2011	\$ 104
2012	100
2013	94
2014	87
2015	79
2016 through 2020	277
	\$ 741

6. Commitments

In October 1997, Artesian Water entered into a 33-year operating lease for a parcel of land with improvements located in South Bethany, a municipality in Sussex County, Delaware. The annual lease payments increase each year by the most recent increase in the Consumer Price Index for

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Urban Workers, CPI-U, as published by the U.S. Department of Labor, Bureau of Labor Statistics. Rental payments for 2010 and 2009 were \$12,700 and \$12,600, respectively. The future minimum rental payment as disclosed in the following table is calculated using CPI-U as of October 31, 2010.

In October 2006, Artesian Water entered into a 3-year contract for office space located in Sussex County, Delaware. In October 2009 the contract term was extended for an additional year and therefore ended in October 2010. Rent payments for 2010 and 2009 were \$40,000 and \$48,000, respectively.

During September 2007, Artesian Water entered into a 3-year contract for office space located in New Castle County, Delaware. The contract ended in August 2010. This location was used as general office space while the Artesian Water main office space was being renovated. Rent payments during 2010 and 2009 were \$53,000 and \$79,000, respectively.

In November 2010, Artesian Water entered into a 5-year contract with Artesian Development Corporation, a subsidiary wholly owned by Artesian Resources, for office space located in Sussex County, Delaware. Rental payments for 2010 were \$15,000.

Future minimum annual rental payments related to operating leases for the years subsequent to 2010 are as follows:

	(In thousands)
2011	\$ 103
2012	103
2013	103
2014	103
2015	89
2016 through 2030	217
	<hr/>
	\$ 718

Artesian Water has one water service interconnection agreement with a neighboring utility, Chester Water Authority, which requires minimum annual purchases. Rates charged under this agreement are subject to change. Effective August 1, 1997, Artesian Water renegotiated the contract with the Chester Water Authority to, among other things, reduce the minimum purchase requirements from 1,459 million gallons to 1,095 million gallons annually, calculated as 3 million gallons per day times the number of calendar days in a year. The agreement is extended through the year 2021.

The Chester Water Authority sent us a notice on March 16, 2009 of a rate increase, effective July 1, 2009. We received a second notice of a rate increase on March 16, 2010, effective July 1, 2010. The minimum annual purchase commitments for all interconnection agreements for 2011

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through 2015 and the aggregate total for the years 2016 through 2021, calculated at the noticed rates, are as follows:

	(In thousands)
2011	\$ 3,770
2012	3,779
2013	3,770
2014	3,769
2015	3,770
2016 through 2021	22,638
	<hr/> \$ 41,496

Expenses for purchased water were approximately \$3,636,000 and \$3,234,000 for the years ended December 31, 2010 and 2009, respectively.

In 2005, Artesian Water entered into a 6-year agreement with Utility Service Co., Inc. to clean and paint tanks from 2006 to 2011 for \$1.9 million. The tank painting expense for 2010 and 2009 was \$364,000, \$358,000, respectively. The expenditure committed for the year 2011 is \$312,000. Budgeted mandatory utility plant expenditures, due to planned governmental highway projects, which require the relocation of Artesian Water's water service mains, expected to be incurred in 2011 through 2015 are as follows:

	(In thousands)
2011	\$ 1,800
2012	2,005
2013	455
2014	455
2015	3,915
	<hr/> \$ 8,630

The exact timing and extent of these relocation projects is controlled primarily by the Delaware Department of Transportation.

7. Related Party Transactions

Artesian Resources Corporation operates as the parent holding company of eight wholly-owned subsidiaries offering water, wastewater and engineering services on the Delmarva Peninsula. The subsidiaries include: Artesian Water, Artesian Water Pennsylvania, Inc., Artesian Water Maryland, Inc., Artesian Wastewater Management, Inc., Artesian Wastewater Maryland, Inc., each a regulated public utility, and three non-regulated subsidiaries; Artesian Utility Development, Inc., Artesian Development Corporation, and Artesian Consulting Engineers. Artesian Water has entered into transactions in the normal course of business with these subsidiaries.

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For the year ended December 31, 2010, Artesian Water had an intercompany loan payable balance due to Artesian Resources Corporation of \$1.7 million. For the year ended December 31, 2009 there was no intercompany loan payable balance due. At December 31, 2009, Artesian Water had available two unsecured lines of credit totaling \$40 million, which were shared with Artesian Water Maryland, Inc. Approximately \$5.5 million of the amount outstanding on these lines of credit at December 31, 2009 was borrowed for use by Artesian Water Maryland, Inc. and is included in receivables on the balance sheet. Artesian Water provides various administrative services to all other subsidiaries, and costs to perform these services are allocated accordingly, primarily based on a percentage of sales of each subsidiary. Artesian Water also has intercompany transactions for temporary federal income tax attributes. For the years ended December 31, 2010 and December 31, 2009 Artesian Water had an intercompany receivable balance from the other subsidiaries of approximately \$258,000 and \$326,000, respectively. For the years ended December 31, 2010 and December 31, 2009, Artesian Water had intercompany water sales of approximately \$81,000 and \$41,000, respectively, from Artesian Water Maryland, Inc. for an interconnection between Delaware and Maryland. For the year ended 2010, Artesian Water had intercompany rent expense of approximately \$15,000 to Artesian Development Corporation for office space located in Sussex County, Delaware.

8. Rate Proceedings

On August 19, 2009, Artesian Water, DEPSC, the Division of the Public Advocate and Christiana Care Health Services, Inc. entered into an agreement to settle Artesian Water's April 2008 application for an increase in rates. PSC Order No. 7657 was signed by the DEPSC on September 22, 2009, approving the settlement agreement, which made the existing 15% temporary increase in base rates permanent. Since the rate was equal to the 15% temporary increase in rates charged to customers since December 17, 2008, Artesian Water was not required to refund any amounts to customers. This settlement also included the agreement that Artesian Water will not apply for a further rate increase for an 18-month period from the date of the DEPSC's order closing this application. It was also agreed that the revenue recovered by the Company pursuant to the settlement does not include any recovery of funds attributable to state income tax expense, as it is unlikely that any state income tax will be paid by Artesian Water during the rate effective period.

Delaware law permits water utilities to put into effect, on a semi-annual basis, increases related to specific types of distribution system improvements through a Distribution System Improvement Charge, or DSIC. This charge may be implemented by water utilities between general rate increase applications that normally recognize changes in a water utility's overall financial position. The DSIC approval process is less costly when compared to the approval process for general rate increase requests. The DSIC rate applied between base rate filings is capped at 7.5% of the amount billed to customers under otherwise applicable rates and charges, and the DSIC rate increase applied cannot exceed 5% within any 12-month period. We did not have DSIC in effect during 2009. During 2010, Artesian Water filed two applications with the DEPSC for approval to

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collect a 0.34% increase and 0.68% increase during the first and second half of the year, respectively. These increases recover the costs of eligible revenue producing improvements made since the last rate increase in 2008, and were calculated to generate approximately \$286,000 in revenue annually. The DEPSC approved the DSIC effective January 1, 2010 and July 1, 2010, subject to audit at a later date. For the year ended December 31, 2010, we earned approximately \$288,000 in DSIC revenue. In November 2010, we filed an application with the DEPSC for approval to increase the DSIC rate to 1.47% effective January 1, 2011, which will generate approximately \$390,000 in revenue on an annual basis.

9. Geographic Concentration of Customers

The Company provides water utility service to customers within its established service territory in all three counties of Delaware, pursuant to rates filed with and approved by the DEPSC. As of December 31, 2010, the Company was serving approximately 77,900 customers.

10. Subsequent Events

Events and transactions subsequent to December 31, 2010 have been evaluated for potential recognition in the financial statements or disclosure in the notes to the financial statements. All events and transactions have been evaluated through April 21, 2011, which is the date the financial statements were available to be issued. During this period, there were no recognized subsequent events requiring recognition in the financial statements. The following subsequent event required disclosure:

On April 11, 2011, Artesian Water filed a request with the Delaware Public Service Commission to implement new rates to meet a requested increase in revenue of 19.45%, or approximately \$10.9 million, on an annualized basis. The new rates are designed to support Artesian Water's ongoing capital improvement program and to cover increased costs of operations, including chemicals and fuel, electricity, taxes, labor and benefits. Artesian Water anticipates implementing a portion of the requested increase as a temporary rate under bond 60 days from the filing date, up to the statutory limit of \$2.5 million on an annual basis, until permanent rates are decided by the Delaware Public Service Commission. Artesian Water's last request to implement new rates was filed in April 2008.